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National Association of Purchasing Management

Report On Business®

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Index Highest Since April 1984

New Orders, Production, Expand 8th Straight Month

Deliveries Slowest Since July 1984

Analysis by the Business Survey Committee; chairman, Robert J. Bretz, C.P.M., director of materials management, Pitney Bowes, Inc.

The *Report on Business* is published monthly by the National Association of Purchasing Management, based on data compiled from replies to questions asked of purchasing managers in some 250 industrial companies. Membership of the Business Survey Committee is diversified geographically, based on value added by state, and by Standard Industrial Classification category, based on each industry's contribution to national income.

August Report

The economy expanded again in August, say the nation's purchasing managers in their latest **Report on Business.** Production grew at a higher rate than in the past three months. New orders also expanded, but at a somewhat slower pace than in July. The speed of vendor deliveries slowed for the 11th consecutive month, reflecting strong growth in production. Inventories increased in August after a decline in July. Employment also expanded for the fifth time in the last six months. For the 12th consecutive month, more purchasers reported price increases than decreases.

The report was issued today by Robert J. Bretz, C.P.M., chair of the National Association of Purchasing Management's Business Survey Committee, and director of materials management at Pitney Bowes, Inc. "The economy continued its vigorous growth in August," Bretz said. "Production was exceptionally strong, considering the normal seasonal slowing, and appeared to be aided by some inventory build-up. The continued rise in new orders virtually assures an excellent third quarter."

The **Purchasing Managers' Composite Index** advanced briskly to 59.9%, from 58.2% in July, the 13th consecutive month this indicator has registered over 50%. The 59.9% is the highest since April 1984 (61.0%). Notes Bretz: "The index has averaged 56.1% for the first eight months of 1987. Based on past experience, if this average were to be maintained for the remainder of 1987, it would be consistent with real GNP growth of 3.7%." A reading above 50% indicates that the economy is generally expanding; below 50%, that the economy is generally declining. The index is based on analysis by the U.S. Department of Commerce. Except for this index, the information in this report is not seasonally adjusted.

Net Difference

In each category measured, this report shows a net difference, the difference between the number of responses in the positive direction (higher, better, faster) and the negative direction (lower, worse, slower). Analysis of the month-to-month difference compares the rate of change.

Employment

After declining in July, employment grew again in August, marking the fifth time it has expanded in the past six months. This is significant, considering February 1987 ended a string of 29 consecutive months in which members reported declining employment.

Employment %	Higher	Same	Lower	Net Differ.
August	16	71	13	+ 3
July	14	69	17	− 3
June	18	70	12	+ 6

Buying Policy

For the second consecutive month, lead times have expanded for production materials, as the number of members reporting lead times of 30 days or fewer has declined to 54% from 56% in July and 58% in June. Lead times for capital expenditures declined, as only 50% reported lead times of six months and longer, down from 56% in July and June; this month's level is the lowest since November 1985 (48%). The lead times for maintenance, repair and operating (MRO) supplies also declined as the number of members reporting lead times of 30 days or fewer rose to 86%, up from 81% in July and 84% in June.

	Hand to Mouth	30 Days	60 Days	90 Days	6 Months and Longer
Production Materials %					
August	14	40	28	13	5
July	16	40	20	15	9
June	15	43	23	11	8
MRO Supplies %					
August	41	45	9	5	0
July	40	41	12	6	1
June	40	44	9	5	2
Capital Expenditures %					
August	8	7	11	24	50
July	9	6	10	19	56
June	9	9	10	16	56

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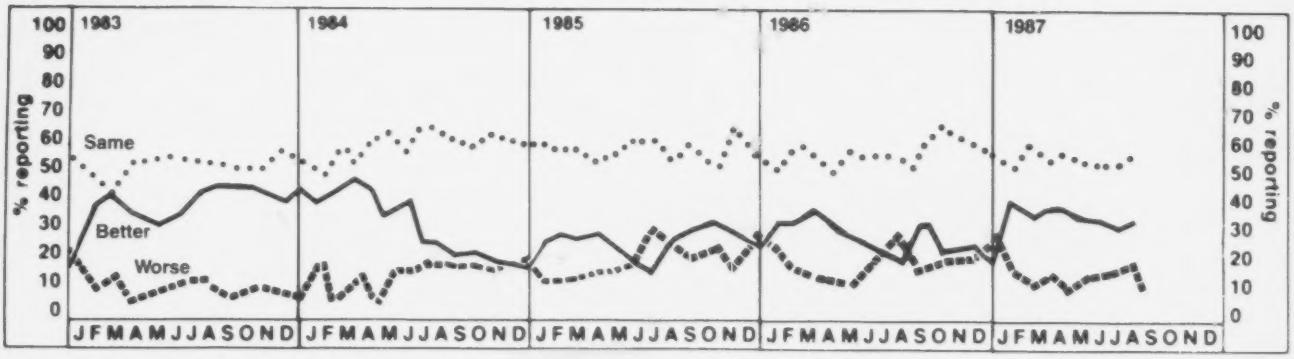
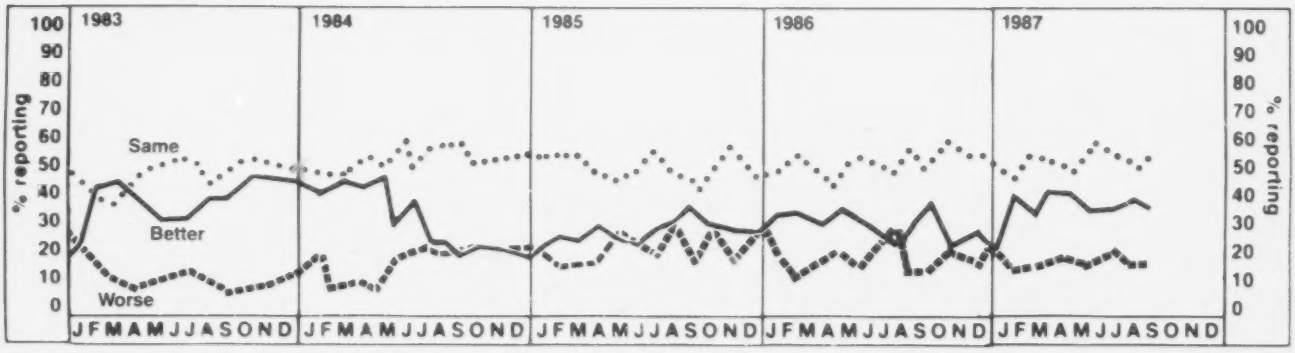
Production



Production grew again in August, for the eighth consecutive month. The rate of growth was the highest since April 1987 and, when normal seasonal slowing is taken into account, showed exceptional vigor.

Production %	Better	Same	Worse	Net
August	33	59	8	+25
July	30	55	15	+15
June	32	55	13	+19

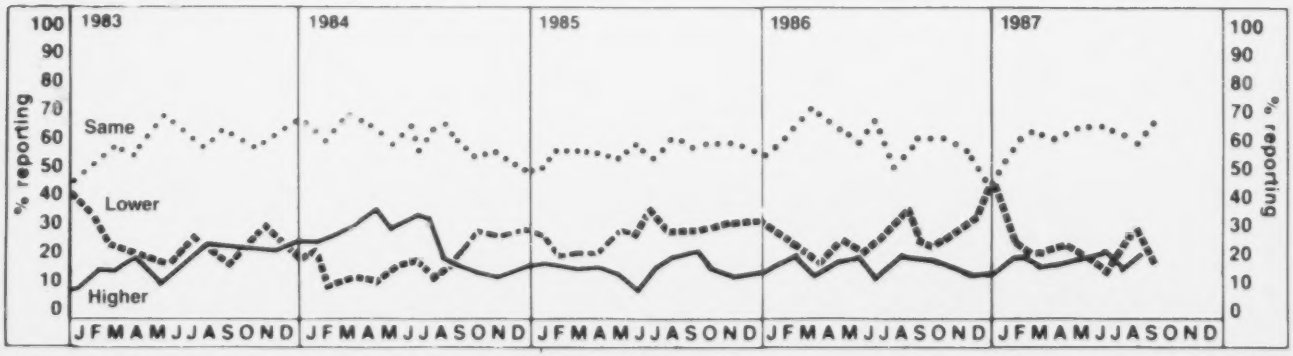
New Orders



New orders grew in August for the eighth consecutive month. Although the rate of growth was slower than last month, the 36% reporting better new orders signals a robust third quarter for production.

New Orders %	Better	Same	Worse	Net
August	36	51	13	+23
July	39	48	13	+26
June	35	50	15	+20

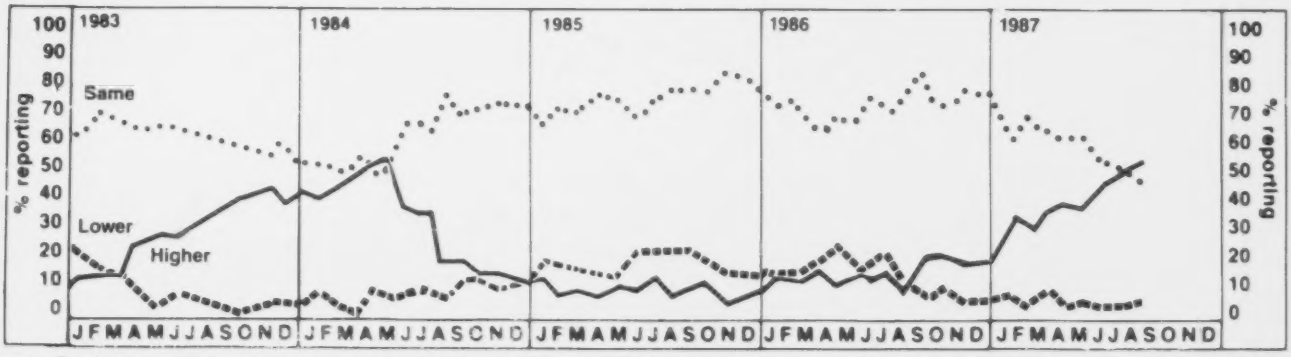
Inventories



Purchasers increased their inventories in August for the third time in the past four months. Some members indicated their increase was in response to a slowing of deliveries; others said they were attempting to bring in products earlier than needed to lessen the effects of announced price increases.

Inventories %	Higher	Same	Lower	Net
August	18	65	17	+ 1
July	13	59	28	−15
June	19	64	17	+ 2

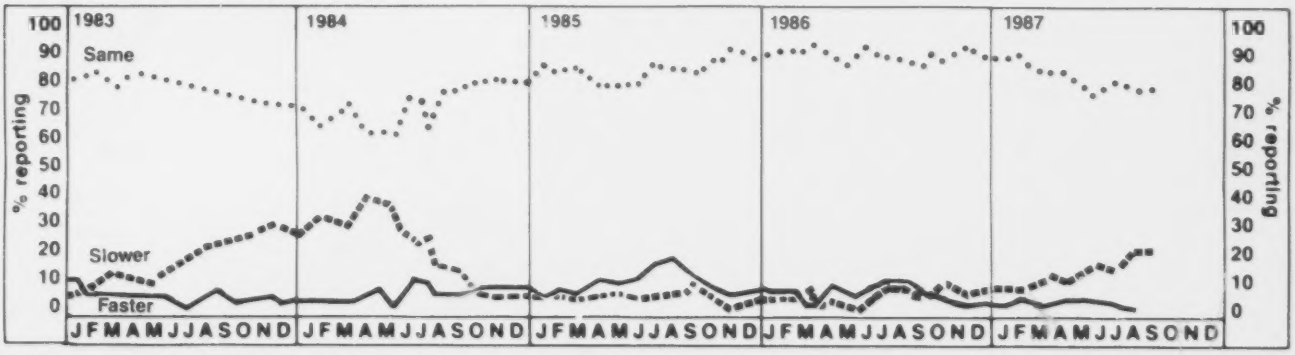
Prices



In September 1986, more purchasing managers reported price increases than decreases, beginning a string of 12 consecutive months in which this has occurred. In August, 52% reported paying higher prices, the most to so report since April 1984 (55%); only 3% reported lower prices. Even so, purchasers still do not expect significant price increases for the balance of 1987.

Prices %	Higher	Same	Lower	Net
August	52	45	3	+49
July	50	48	2	+48
June	48	50	2	+46

Vendor Deliveries



Vendor deliveries slowed in August for the 11th consecutive month, mirroring the strength in production. The 18% net difference between those reporting slower deliveries (20%) and those reporting faster (2%), is the greatest since July 1984 (19%). Purchasers continue to report difficulty in receiving many metal- and plastic-related chemicals and resins on schedule.

Vendor Deliveries %	Faster	Same	Slower	Net
August	2	78	20	−18
July	3	77	20	−17
June	5	80	15	−10

Specific Commodity Changes

Reported lower in price in August were benzene (after being reported higher priced for six of the previous eight months), styrene (after being reported up in price for five consecutive months) and natural gas (lower for the fifth consecutive month). Steel, steel plates and cold rolled steel sheets were reported in short supply for the third consecutive month. Caustic soda was also reported in short supply (third consecutive month), as were plastic resins. Titanium dioxide, reported short in supply for 10 of the 12 months ending February 1987, was also reported short in August.

Linerboard and corrugated shipping containers were reported higher in price for the 16th time in 17 months. Chlorine (third consecutive month), caustic soda (ninth consecutive month), and many miscellaneous chemicals were also reported up in price. Petroleum-derived chemicals and plastic-related items that have increased in price were ethylene, polypropylene, polyethylene, plastic resins and products (the latter two for the third consecutive month).

Numerous metals were reported higher priced, including steel (11th time in the last 12 months), steel plate and stainless steel sheets (both for the second consecutive month), aluminum (seventh consecutive month), brass (third time in past five months), copper (sixth consecutive month), zinc (third consecutive month), nickel and lead. Fuel oil was reported up in price (seventh time in the past eight months) as was diesel fuel (third time in the last four months).

UP in Price: Corrugated shipping containers, kraft linerboard (used in making corrugated shipping containers), chlorine (used heavily in making bleached paper and paperboard), caustic soda (used heavily in paper-making and petroleum refining), aluminum, brass, copper, lead, nickel, zinc, steel (particularly stainless steel sheets, steel plate, hot and cold rolled sheets), plastic reins, polyethylene, polypropylene (used in making thermoplastic plastics or fibers), plastic products, ethylene (used heavily in making plastic resins), fuel and diesel oil and miscellaneous chemicals.

DOWN in Price: Natural gas, benzene and styrene.

In SHORT Supply: Steel, steel plate, cold rolled steel sheets, caustic soda, titanium dioxide (a lead-free pigment used heavily as a whitener in coatings and in other industrial applications) and plastic resins.

The National Association of Purchasing Management's *Report on Business* records the actual changes and rates of change in five important categories of data: production, new orders, employment, inventories and vendor deliveries. These five components, as reported, are not adjusted to compensate for seasonal variations.

Economists have devised a variety of formulas to compensate data for seasonal variations. N.A.P.M. cooperates with the U.S. Department of Commerce, which prepares the monthly Purchasing Managers' Composite Index for publication by N.A.P.M. The Department of Commerce adjusts the five above-mentioned components of the *Report on Business*, applies various weights to each and combines them into a single index number. The Composite Index is based on analysis by the U.S. Department of Commerce, and is the only part of the report adjusted for seasonal variations.

Note: The next issue of the *Report on Business* will be available Oct. 5, 1987.

Commodity Reports

Energy

Prepared by the N.A.P.M. Energy Committee; chairman, Howard T. Perley, C.P.M., International Paper Company, Memphis TN.

Petroleum Products

Fuel oil prices continued to increase through the summer due to OPEC's renewed effort to maintain quotas, and the unstable conditions in the Persian Gulf. Gasoline and heating oil supplies remained stable as refineries maintained production levels. Current prices are expected to be maintained, with more potential on the upside than downside, as seasonal third quarter demand factors take hold. (Terry Palmer, C.P.M., Standard Oil Production Company, Dallas, TX)

Natural Gas

Gas supplies should be ample again this winter. While there may be regional spot shortages, particularly in Texas and Louisiana, widespread curtailments are unlikely. The current excess of supply over demand may not continue beyond 1990, because the U.S. is consuming more gas than it is finding. Following last year's decline in drilling activity, additions to well reserves are now only about a third of the volume produced. Production capability still exceeds consumption, but by the end of the decade the two may come into balance. Prices will likely then firm up and regional shortages will become more frequent. Spot prices for gas purchased directly from producers have not rebounded from last year's decline, but a further decline is not likely either. However, tariff prices for gas sold by local utilities will continue to drop this year and next. For end-users who make their own spot gas purchases, the margin of savings over tariff purchases will continue to decline. (Ian C. Mackenzie, C.P.M., Corning Glass Works, Corning, NY)

Coal

The coal industry continues to be in an over-capacity position, and industrial entities and utilities are making every effort to purchase their coal requirements on the spot market. This may be the time for small users, 100,000 ton year or less, to lock in their requirements for a longer term with a set escalator. The important factor in purchasing coal is to work on the delivered cost-per-million btu. Normally coal is 20%-40% of that delivered cost, so more attention should be placed on transportation. (Gary Chesnut, Ag Processing Inc., Omaha, NE)

Electricity

Price increases for 1988 and following years are expected to be quite moderate. Reductions in the capital component of the "average" utility's tariff rates will hold rate increases at a level from 1 to 2 percentage points below inflation. However, "average" expectations for electricity prices are totally misleading. New England customers particularly could see prices increasing above the rate of inflation. Each utility has construction programs, capital requirements and regulatory climates that are unique. These overshadow fuel and operating costs, which are more predictable as an "average." For the industry, capital costs comprise 46% of total costs. Fuel costs are also contributing to the control of electricity costs. Natural gas use by electricity generation sector is expected to increase by almost 10% in 1988. At the same time, the cost of natural gas to utilities is decreasing. Again, the effect of these fuel cost reductions will be felt very unevenly by industrial consumers. Historically, industrial consumers of electricity have been required to subsidize the residential customer class through rate structures that discount the lower cost of service to industrial users. Opportunities exist with most local utilities to reduce these "overcharges" through utilization of existing special rates, aggressive negotiations for contract rates, rate case interventions, and/or actual or proposed bypass of the utility through cogeneration applications. (George T. Gillespie, C.P.M., Abbott Laboratories, North Chicago, IL)

Steel

Prepared by the N.A.P.M. Steel Committee; chairman, Daniel R. Krause, C.P.M., The Budd Company, Troy, MI.

The first half of 1987 ends as one of the best six-month periods in recent years for the domestic steel mills. Order books were full and the major integrated mills are expected to report profitable operations. Present demand shows no signs of diminishing, particularly with coated sheets, hot and cold rolled sheets, and plates and structurals, with mills accepting orders for delivery up to 12-16 weeks out.

However, one has to look at the plethora of factors influencing the steel industry to understand the reasons for the extended leadtimes and recently announced price increases, when total domestic production will probably be, at best, 75 million tons, only 7% above 1986. Some of these factors have been: the long strikes at USX and Babcock and Wilcox, slowness of USX to attain full production, low customer inventories coupled with improving sales, and the idling of capacity from the 1985 and early 1986 level. Overall, both the industry and its customers underestimated the effects of an improving economy and the depreciating dollar on the demand for, and availability of, steel products.

Of great concern to the steel industry, especially those producing hot and cold rolled sheets, coated products, and plates, is the expiring labor contracts of some of the major steel consumers in the automotive, farm implement and construction equipment industries this fall and in 1988. Cutbacks in production from these customers could change the expected positive outlook for 1987 and 1988.

However, today's topsy-turvy steel marketplace will settle down somewhat during the last half of 1987 as supply and demand begin to get back into balance. And the price increases, which have been directed more at the steel service centers, will tend to fade away as the marketplace stabilizes. (Norris E. Caudell, Caterpillar Inc., Peoria, IL)